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numbers = value



Dynetek Industries Ltd.



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## FINANCIAL HIGHLIGHTS

NOTE: 2003 ■  
2002 ■

December 31

*(thousands of Canadian dollars, except share capital and per share data)*

REVENUE		
Cylinder and system sales	<b>16,348</b>	10,871
Research and development income	<b>4,044</b>	1,965
Investment and other income	<b>441</b>	584
Total revenue	<b>20,833</b>	13,420
Net loss	<b>(4,888)</b>	(4,933)
Net loss per common share (basic and fully diluted)	<b>(0.24)</b>	(0.24)
Capital expenditures	<b>3,376</b>	2,400
Cash and cash equivalents	<b>9,831</b>	20,453
Total assets	<b>45,407</b>	49,371
Long-term debt	<b>1,753</b>	1,457
Common shares outstanding	<b>20,120,395</b>	20,120,395
Weighted average common shares outstanding	<b>20,120,395</b>	20,120,395





“Value is about world-class technology that sets us apart from our peers. It’s about executing a business strategy and positioning ourselves to capitalize on new opportunities. It’s about how we conduct business to achieve superior goals. It’s about supportive strategic partners and customers, and the unique solutions we provide them. It’s about commitment to ethics, integrity, excellence and a vision to be an industry leader.”

Robb Thompson  
President and CEO



# letter to shareholders & employees

The year ended December 31, 2003 was a year of significant growth and value-added solutions for our customers and strategic partners.

**World-class technology that sets us apart from our peers.** Dynetek, in the compressed gas storage market, is well beyond the “promise” but onto delivering “product” in our core technology. Our goal has been to deliver a product our customers and partners can use today for compressed natural gas (CNG) and hydrogen storage. Our increased growth confirms we are designing, manufacturing and delivering today.

**Executing a business strategy and positioning ourselves to capitalize on new opportunities.** During 2003 the Company increased sales to our compressed natural gas customers by 46%. We also showed continued growth in our hydrogen storage revenue by 59% through additional Original Equipment Manufacturers (OEMs) and projects, and we developed other compressed gas storage applications with companies such as Raytheon Company for helium storage. In addition, we continued to expand our global sales reach, not only to new geographic areas but with new long-term strategic customers.

**Conducting business to achieve superior goals.** In 2001 and 2002 we stated we were positioning ourselves for growth and to capitalize on new opportunities. Cylinder and system sales revenues increased 36% from 2001 to 2002 and 50% from 2002 to 2003. Dynetek is committed to this growth profile with new technological advances, extended global reach and increased customer sales penetration.

**Supportive strategic partners and customers, and the unique solutions we provide them.** The hydrogen storage market is very visible and globally supported. Countries around the world are committing billions of dollars towards the hydrogen economy. Although there will be much debate on the timing of this economy, Dynetek is playing a lead role in bridging today's oil and gas economy with the alternative energy world. Dynetek is involved with 10 different OEMs, including Ford, DaimlerChrysler and Nissan, to design, manufacture and deliver the hydrogen storage on 16 confidential development projects. Our leadership in hydrogen storage was confirmed by contract awards to design, manufacture and deliver almost all of the compressed hydrogen storage projects for vehicle applications announced worldwide by OEMs in 2003. Dynetek announced delivery of storage solutions for 30 fuel cell bus engines for the European Fuel Cell Bus Project in 10 different cities; 60 on-board hydrogen fuel storage units for DaimlerChrysler's Mercedes A Class fuel cell vehicle; and the on-board hydrogen fuel storage units for Ford Motor Company's Focus FCV zero emission automobiles. We view our complete light-weight storage solutions as the enabling technology for our customers and partners to achieve their strategic goals.

Underlying all of these achievements is our commitment to ethics, integrity, excellence and a vision to be an industry leader.

## 2003 REVIEW OF OPERATIONS

During 2003, Dynetek made significant advances in operations. We added shareholder value through increased sales, we continued production economies and we strengthened strategic alliances and partnerships including:

### January

- Dynetek supplied the stationary compressed hydrogen storage system to Stuart Energy as part of its patented intelligent hydrogen



fueling station. The system was installed at Toyota's headquarters in Torrance, California, to support the company's new fuel cell vehicle.

- received orders to supply its 10000psi (700bar) hydrogen storage system for Ford's hybrid Model U which combines a four cylinder internal combustion engine and a hybrid electric transmission.

#### **February**

- received orders from Deere and Company (John Deere) to supply its 5000psi (350bar) hydrogen storage system as part of a technology demonstrator fuel cell commercial work vehicle (CWV).

#### **May**

- Dynetek announced a Strategic Alliance with enviroMECH Industries Inc. (EMI) to develop and install complete fuel storage solutions for the compressed gas market in North America. The alliance will focus initially on the CNG transport and power generation industries in California.

#### **June**

- Dynetek received orders for 800 lightweight cylinders for delivery to major Japanese carmakers and bus manufacturers for CNG vehicles.

#### **July**

- Dynetek delivered US DOT certified composite helium trailers to Raytheon Company.

#### **September**

- received orders for the first significant compressed natural gas bus storage orders for the European market.
- Dynetek delivered its lightweight CNG fuel storage system for the joint development project between Isuzu and Westport of their CNG-DI truck displayed at 2003 Challenge Bibendum.
- Dynetek signed a strategic alliance agreement for the supply of stationary hydrogen storage systems relating to Stuart Energy's Hydrogen Energy Station (HES) line.

#### **December**

- Dynetek was chosen to deliver three additional on-board hydrogen storage systems for fuel cell buses bound for Perth, Australia for Ballard Power and EvoBus.
- Dynetek was chosen by Ford to deliver on-board complete hydrogen fuel storage systems for the 2004 Ford Focus FCV zero emission automobiles.

Overall, the year 2003 confirmed our strategic initiatives for penetrating the US, European and Japanese compressed natural gas markets. Revenue generation from these geographic areas were key to our 55% growth over 2002. Our hydrogen sales increases further confirmed our leading edge technology in compressed hydrogen storage amongst our competitors.



## OUTLOOK

Dynetek is unlike others in the alternative energy market. We design, commercially manufacture and deliver complete system solutions into the existing and growing global CNG market, and we provide leading technology that supports the success of the hydrogen economy.


We believe our energy storage solutions for hydrogen and CNG will lead the transformation to a globally secure and sustainable energy system and provide enormous growth potential for our shareholders. We believe the need for sustainable and secure energy sources is accelerating rapidly, thus further reinforcing the need for safe and cost effective natural gas and hydrogen storage system solutions. We are committed to making cost reductions in every component of our products and are confident these actions will allow us to provide our customers with highly effective, robust, reliable and cost-competitive storage solutions.

As stated in 2002, the Company is driving towards reporting positive cash flow per share during 2004. Although we anticipate an overall loss in 2004, we expect to show positive earnings before interest, taxes, depreciation and amortization (EBITDA)\* for the fourth quarter of 2004 and annually beginning in 2005. This will result from increased sales and reduced production costs, both of which we are positioned to achieve during the coming year. The Company continues to show financial discipline every day and will continue to operate in this manner to ensure we reach our goals.

## A WORD OF THANKS

I would like to thank our shareholders and each of our employees for making 2003 a success. I would also like to extend my thanks to our customers, suppliers and partners for their support of Dynetek for our gaseous fuel storage systems. In addition, I would like to acknowledge our Board of Directors for their unfailing sense of responsibility, guidance and support, which made for an outstanding contribution to our successful growth.

On behalf of Dynetek's management team and Board of Directors, respectfully,



Robb D. Thompson  
President and CEO  
March 10, 2004

\* Earnings before interest, taxes, depreciation and amortization (EBITDA) is a non-GAAP measure and may not be comparable to similar measures used by other companies. Management believes EBITDA is a useful measure to assist in the assessment of Dynetek's ability to generate cash flows from its operations.





# =60

Dynetek provided 60 on-board hydrogen storage systems to DaimlerChrysler for its Mercedes A Class fuel cell vehicle, and provided the storage solution to Ford Motor Company for its Focus FCV zero emission automobile.



# the company we keep

Dynetek provides complete storage solutions for compressed gases, primarily natural gas and hydrogen. The Company is recognized as one of the world leaders in the development and manufacturing of light weight cylinders. The DyneCell®, Dynetek's core technology, is composed of a thin-walled seamless aluminum liner covered by corrosion-resistant carbon fibre.

A Type 3 cylinder, the DyneCell is the fastest filling cylinder in the market and is designed to store a variety of high pressure gases. Dynetek has designed, manufactured, marketed and supplied the DyneCell cylinders and complete storage systems to worldwide major automotive and heavy-duty vehicle manufacturers, and to companies in the industrial gas, transportation and energy sectors.


The development of the alternative fuel industry is being driven by three independent market factors – economics, energy independence and environmental concerns. Due to the abundance and economic advantages of gaseous fuels in world-wide markets, many countries and geographic regions are mandating the use of alternative fuels, to realize energy independence, economic benefit and environmentally suitable solutions.

We believe that the markets for gaseous fuel vehicles and other applications will continue to grow and that end users will place more emphasis on technology advancement and economic advantage. Based on the size and growth rate for the use of alternative fuel, we have focused our marketing efforts in Japan, Europe and North America. Future growth areas being evaluated are South America and the Asia – Pacific region.

Following is a selection of customers and strategic partners utilizing our products and storage solutions:

- |                               |                 |                |                |
|-------------------------------|-----------------|----------------|----------------|
| • Mitsubishi                  | • Stuart Energy | • Thomas Built | • IVECO        |
| • JFE Containers (Kokan Drum) | • Ballard Power | • Freightliner | • IRIS Bus     |
| • Ford                        | • Hydrogenics   | • Elgin        | • OMNI         |
| • DaimlerChrysler             | • John Deere    | • McNeilus     | • Chance Coach |
| • Nissan                      | • Raytheon      | • NEOMAN       |                |





# =20

Dynetek provides complete and certified fuel storage solutions to a variety of customers in more than 20 countries.



# our market penetration

We manage our business with one objective in mind: improving our financial results. Our goal is to increase revenue, generate positive cash flow, attain positive earnings per share and create long-term shareholder value.

To make this happen we forge ahead on two distinct but complementary fronts:


- we manage today's business: a growing commercial enterprise with customers spanning the globe in the compressed natural gas market
- we are developing tomorrow's business; through the outstanding efforts of our research and development team we are advancing the hydrogen economy while partnering with our numerous customers and strategic partners

The compressed natural gas market accounted for the majority of our revenues in 2003. The natural gas market is a growing and sustainable business which will provide the Company increased revenue growth year on year. Many industry observers find it difficult to agree on the timeline for the hydrogen economy. Dynetek is convinced the hydrogen economy is coming: it's only a question of when. In the meantime, our strategy is to create and sustain positive cash flow and earnings per share with our compressed natural gas business, and other compressed gases such as helium and oxygen.

During the past 18 months the Company focused activities in three CNG markets: the bus, heavy duty-truck and passenger vehicle markets. Tremendous inroads were made in all areas. Firstly, our German operations substantially increased our market acceptance and penetration in the European bus market. Secondly, through our strategic alliance with EMI, we substantially increased our market acceptance and penetration in the California sweeper and refuse truck market. Thirdly, through our strategic alliance with JFE Containers (Kokan Drum), we increased our sales revenues in the Japanese passenger vehicle market by 182% over 2002. All of these activities were significant contributors to our 55% increase in revenues for 2003.

Based on the world's enormous natural gas reserves, Dynetek is convinced the global CNG market will continue to grow at a pace that will support our ongoing operations to profitability while the hydrogen economy matures and develops.





# = 55%

Total revenue increased by 22% from 2002 to 2003. Equipment and system sales increased 50% and research and development income increased 100%.



# our research & development commitments

Dynetek will continue to invest in research and development. We are concentrating our efforts on producing an even lighter fuel storage system and developing cylinders with larger storage capacities requiring less space through higher pressures. We are also developing valve and regulator solutions for high pressure hydrogen storage which will be approved and certified by recognized third parties to ensure they are robust and reliable for everyday use by the OEMs.

Dynetek works with some of the world's largest OEMs - including Ford, DaimlerChrysler and Nissan - to design, develop, manufacture and deliver complete, compressed gas storage solutions. We will continue to meet industry standards set by the numerous regulatory bodies and industry partners, including but not limited to, Transport Canada, US Department of Transportation (DOT), the National Fire Prevention Association, TUV, ISO, European Integrated Hydrogen Project (EIHP), KHK – Japan, CSA B51 and NGV2. Approvals and certification enhance the acceptability and quality of our products. We continually meet the highest level of certification for our product before we enter a market to ensure safety, endurance, strength, durability and quality.

- In November 2000 the Company announced its 350bar (5000psi) lightweight fuel storage system as the only system, on a world wide basis, to receive certification in Germany (TUV), North America (NGV2) and Japan (KHK).
- In July 2002 the Company announced the successful testing of the world's first 825bar (12500psi) lightweight composite storage cylinder. The cylinder was developed for hydrogen storage at refueling stations.
- In July 2003 the Company announced the delivery of a composite lightweight helium trailer to Raytheon Company, designed and manufactured by Dynetek with US DOT certification.
- In 2004 the Company expects to announce certification of a 350bar (5000psi) valve and regulator for hydrogen applications. The Company has committed to providing a quality product which is reliable, robust and durable for everyday use.

The Company is also working with a number of OEMs to design and manufacture complete storage system solutions for 700bar (10000psi). The systems will be certified and approved to the highest known standards, including EIHP and KHK. The Company anticipates delivery of the complete system, including peripherals such as valves, regulators and plumbing in early 2005.

Our focus on research and development reinforces our commitment to advancing our alternative energy technology and systems, and to improving performance and reducing commercial cost. We will continue to actively seek joint development programs and strategic alliances with major fuel cell developers and industry leaders in this market.





# =10000 psi

Dynatek has partnered with several OEMs to design, develop and manufacture complete storage systems for 10000 psi (10000psi)



# management's discussion & analysis

The following sets out management's discussion and analysis of our financial condition and results of operations for the years ended December 31, 2003 and 2002 and is based on information available as at March 10, 2004. All financial information is presented in Canadian dollars. Our consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP).

## FORWARD-LOOKING STATEMENTS

In addition to historical information, this Annual Report and the following discussion and analysis of financial condition and results of operations contains forward-looking statements and should be read in conjunction with the financial statements and related notes for the year ended December 31. Forward-looking statements are based upon current assumptions, expectations and estimates that involve a number of risks and uncertainties and actual results could differ materially from those discussed in the forward-looking statements. Readers are encouraged to review the section in the Management's Discussion and Analysis titled 'Principal Risks and Uncertainties' for a discussion of factors that could affect Dynetek's future operations and financial results. Dynetek does not update forward-looking statements should circumstances or management's assumptions, expectations or estimates change.

## PERFORMANCE WITH 2002

2003 was a year of continued global revenue growth in the compressed natural gas (CNG) market and the commitment of Dynetek to be a technological leader in providing hydrogen storage solutions. We continue to follow our business plan and to position ourselves to capture additional market share and grow our revenues. We added shareholder value not only through increased sales, but production economies and strategic alliances and partnerships including:

- In January, Dynetek supplied a stationary compressed hydrogen storage system to Stuart Energy as part of its patented intelligent hydrogen fueling station, installed at Toyota's headquarters in Torrance, California, to support Toyota's new fuel cell vehicle roll-out.
- In January, Dynetek received orders to supply its 10000psi (700bar) hydrogen storage system for Ford's hybrid Model U which combines a four cylinder internal combustion engine and a hybrid electric transmission.
- In February, Dynetek received orders from Deere and Company (John Deere) to supply its 5000psi (350bar) hydrogen storage system as part of a technology demonstrator fuel cell commercial work vehicle (CWV).
- In May, Dynetek announced a Strategic Alliance with enviroMECH Industries Inc. (EMI) to develop and install complete fuel storage solutions for the compressed natural gas market in North America. The alliance will focus initially on the CNG transport and power generation industries in California.
- In June, Dynetek received orders for 800 lightweight cylinders for delivery to the Japanese market to major Japanese carmakers and bus manufacturers for their CNG vehicles.
- In July, Dynetek delivered US Department of Transportation (DOT) certified composite helium storage trailers to Raytheon Company.



- In September, Dynetek received orders for the first significant compressed natural gas bus storage orders for the European market.
- In September, Dynetek delivered its lightweight CNG fuel storage system for the joint development project between Isuzu and Westport of their CNG-DI truck displayed at 2003 Challenge Bibendum.
- In September, Dynetek signed a strategic alliance agreement relating to the supply of stationary hydrogen storage systems for Stuart Energy's Hydrogen Energy Station (HES) line.
- In December, Dynetek was chosen to deliver three additional on-board hydrogen storage systems for fuel cell buses bound for Perth, Australia for Ballard Power and EvoBus.
- In December, Dynetek was chosen by Ford Motor Company to deliver on-board complete hydrogen fuel storage systems for the 2004 Ford Focus FCV zero emission automobiles.

## CORPORATE OVERVIEW

Dynetek Industries Ltd. is a leading international company engaged in the design, production and marketing of Advanced Lightweight Fuel Storage Systems™, and high pressure components including valves and regulators. The key component of the storage system is the DyneCell® cylinder, capable of storing high pressure gases including compressed natural gas, hydrogen, and various industrial gases. Dynetek's DyneCell cylinder and fuel storage system applications include but are not limited to: the transportation industry, including passenger automobiles, light and heavy-duty trucks, transit and school buses; the bulk hauling of compressed gases; and stationary storage or ground storage refueling applications.

The current growth market for our compressed gas fuel systems for alternative fuel applications is the expanding world market for passenger and fleet vehicles powered by internal combustion engines using compressed natural gas. Based on the size and growth rate for alternative fuel vehicles, we have initially focused our marketing efforts in Japan, Europe, and North America. We also continue to pursue the industrial compressed gas market for bulk hauling applications. We are currently targeting the North American market with our large trailer applications. To achieve success and to make significant penetration of this market, our trailers will require having both Transport Canada and US Department of Transportation certification. We expect to have both certifications in place later in 2004.

We believe that the market for our compressed hydrogen enabling technologies will continue to develop over the next 5 to 10 years in conjunction with the expected commercialization of hydrogen as a fuel for internal combustion engines and fuel cells. We plan to continue the development of our enabling technologies to meet this market opportunity. We plan to focus our marketing efforts in North America, Japan and Europe where the majority of our Original Equipment Manufacturers (OEMs) and other hydrogen related technology partners are today.

Our products and services consist primarily of fuel storage, fuel delivery and system integration for alternative compressed gas vehicles, fuel cell applications and hydrogen refueling and stationary storage products.



We offer the following products and services to enable the development and commercialization of these systems:

- Fuel storage – advanced thin-walled lightweight storage cylinders that provide cost effective storage for CNG, compressed hydrogen and other industrial compressed gases, such as oxygen and helium.
- Fuel delivery – pressure regulators, valves and other components designed to control the pressure and flow of compressed gas; and
- System integration – services to design and integrate complete fuel storage systems to meet OEM requirements.

### Financial Highlights

*(thousands of Canadian dollars, except share capital and per share data)*

#### December 31

	2003	2002	2001
<b>Revenue</b>			
Cylinder and system sales	<b>16,348</b>	10,871	8,013
Research and development income	<b>4,044</b>	1,965	1,476
Investment and other income	<b>441</b>	584	1,502
	<b>20,833</b>	13,420	10,991
 Net loss	 <b>(4,888)</b>	 (4,933)	 (1,156)
Net loss per common share (basic and fully diluted)	<b>(0.24)</b>	(0.24)	(0.06)
Capital expenditures	<b>3,376</b>	2,400	7,213
Cash and cash equivalents	<b>9,831</b>	20,453	32,072
Total assets	<b>45,407</b>	49,371	53,523
Long-term debt	<b>1,753</b>	1,457	953
Common shares outstanding	<b>20,120,395</b>	20,120,395	20,120,395
Weighted average common shares outstanding	<b>20,120,395</b>	20,120,395	19,549,622

Overall, the year 2003 confirmed our strategic initiatives for penetrating the US, Japanese and European compressed natural gas markets. Revenues from these geographic areas were instrumental to our 55% growth in revenues over 2002. Our hydrogen storage sales increase confirmed the value of our technology in compressed hydrogen storage. Dynetek was chosen to design, manufacture and deliver almost all of the compressed hydrogen storage projects for vehicle applications announced by OEMs world wide in 2003.

The Company's 2003 cylinder and system sales revenues were 50% higher than 2002 and consistent with the increase from 2001 of 36%. During 2003 Dynetek continued to sell its product to the automotive, refuse truck and transit bus market in both CNG and hydrogen alternative fuel markets. From 2001 through 2003 Dynetek has increased the number of complete fueling systems sold in the areas of transit buses (both hydrogen and CNG), refuse truck (CNG) and automotive applications (both hydrogen and CNG). Through successful sales the Company broadened its customer base by selling into the industrial gas market and the stationary storage market.



## Results of Operations

### Revenues

(thousands of Canadian dollars)

	2003	% of revenues	2002	% of revenues
	\$		\$	
Cylinder and system sales	16,348	78%	10,871	81%
Research and development income	4,044	19%	1,965	15%
Investment and other income	441	3%	584	4%
	<u>20,833</u>	100%	<u>13,420</u>	100%

**Cylinder and system sales** for the year ended December 31, 2003 were \$16.3 million, up 50% from \$10.9 million for 2002. During 2003, some of the customers who purchased the DyneCell fuel storage systems for CNG were: Marubeni Metals Corp. (Japan), Elgin Sweeper Company (United States), Thomas Built Buses (United States) NEOMAN (Germany) and Carmenita Truck Centre (United States). Customers who purchased hydrogen and other compressed gas fuel storage systems were: General Hydrogen (Canada), Stuart Energy (Canada), Daimler Chrysler (Germany), Ford Motor Company (United States), Raytheon (United States), JFE Container Co. (Japan), Ballard Power (Canada) and Hydrogenics (Canada).

Cylinder and systems sales are expected to increase at rates comparable to the past provided that Dynetek is able to continue to penetrate the CNG markets in Japan, Europe and North America.

**Research and development income** for the year ended December 31, 2003 was \$4.0 million, up 106% or \$2.1 million from 2002. During 2003, Dynetek was involved with Natural Resources Canada (NRCan) and 10 different Original Equipment Manufacturers including Ford, DaimlerChrysler and Nissan to design, manufacture and deliver hydrogen storage on 16 confidential development programs. The revenues which Dynetek receives from the OEMs regarding these projects are recorded on billing milestones outlined in the contracts and, therefore, timing differences occur between when costs are incurred and funding is received. Funding received from NRCan recorded as a loan is repayable as a royalty percentage from future sales of products developed. Funding received from NRCan which is not repayable is recorded as revenues in the period it is invoiced.

Research and development income is dependent on OEM and government funding. It is difficult to predict the timing and demand of these customers and therefore research and development income can vary significantly from year to year.

**Investment and other income** for the year ended December 31, 2003 was \$0.4 million, compared to \$0.6 million in 2002. The decrease in investment and other income is a result of less cash available for investment in 2003 and a decrease in interest rates relative to 2002.

Investment income is dependent on the amount of cash Dynetek has to invest. Dynetek only invests in triple A rated securities and therefore earns interest at these rates.



### Costs of Goods Sold and Gross Margin

(thousands of Canadian dollars)

	2003	2002
Cost of goods sold	12,933	8,238
Gross Margin	3,415	2,633
Percentage of Sales	21%	24%

**Cost of goods sold** was \$12.9 million for the year ended December 31, 2003 compared to \$8.2 million for the same period in 2002. Correspondingly, gross margins were \$3.4 million, or 21% of sales compared to \$2.6 million or 24% of sales in 2002.

Cost of goods sold comprises materials, direct labour costs and benefits, and indirect labour costs and overhead associated with the production.

Changes in gross margin percentages were attributed to the product mix. The product mix in 2003 included an increase in system sales having lower margins than cylinder sales. The Company pursues system sales because it increases the Company's CNG market penetration.

The Company anticipates that in future years the gross margin as a percentage of sales will continue to be influenced by the product mix and complete system sales. The costs associated with the initial penetration of the California market created lower than expected margin on the system sales. The Company anticipates the margin to improve beyond 21% in 2004.

### General and Administrative

(thousands of Canadian dollars)

	2003	2002
General and administrative expense	3,458	3,232

**General and administrative** expense was \$3.5 million in 2003 compared to \$3.2 million for 2002. General and administrative expense includes labour and benefits for corporate staff, professional fees, insurance, travel and statutory expenses associated with being a public company. The increase in general and administrative expense was mainly a result of increased head count and related costs, insurance premiums and higher internal costs incurred related to increased production in the European operation. Overall general and administration expenses decreased as a percentage of revenue from 24% in 2002 to 17% in 2003.

In 2004 the Company anticipates that general and administrative expenses should continue to decrease as an overall percentage of sales as the infrastructure costs necessary to implement our business plan have substantially been put into place during 2002 and 2003.



## Research and Development

(thousands of Canadian dollars)

	2003	2002
Research and development expense	4,775	4,202

**Research and development expense** was \$4.8 million in 2003 compared to \$4.2 million in 2002. Research and development expense consists of materials, labour and costs of benefits and the overhead related to research and development activity. During 2003, Dynetek increased the number of research and development personnel by 30%, research on cylinder, regulator and valve development for higher pressure solutions and expanded the number of hydrogen OEM projects.

The majority of Dynetek's research and development programs are co-funded with major OEMs and government (NRCan). These revenues, which Dynetek receives from the OEMs regarding these projects, are recorded on billing milestones outlined in the contracts and therefore timing differences occur between when costs are incurred and funding is received. The funding from the OEMs is recorded as research and development revenue and the repayable government funding is recorded as a loan. Funding received from NRCan which is not repayable is recorded as revenue in the period it is invoiced.

Research and development expense is dependent on OEM projects and government funding. It is difficult to predict the timing and demand of these customers and therefore research and development expense can vary significantly from year to year.

## Marketing

(thousands of Canadian dollars)

	2003	2002
Marketing expense	1,504	1,579

**Marketing** expense was \$1.5 million in 2003 compared to \$1.6 million in 2002. Marketing expenses relate to labour and benefits of sales personnel, travel, attendance at tradeshow, and promotional collateral. Marketing expense was comparable to 2002 as the expansion of the Company's sales force to service the existing and expanding customer base as well as the enhancement of Dynetek's profile in the global marketplace was substantially initiated in 2002. The trade shows Dynetek attended during 2003 included: Clean Heavy Duty Vehicles Conference Tempe, AZ, CaFCP Technology Forum Sacramento, CA, Waste Expo Las Vegas, NV, ENGVA Nice, France, World Hydrogen Energy Conference Montreal, PQ, APTA Expo 2002 Las Vegas, NV, NGV 2002 Washington, DC, CNG-GNC Conference Brazil and the Ford Focus Drive Across Canada.

In 2004 the Company anticipates the marketing expense should decrease as an overall percentage of sales. This decrease will result because of Dynetek's past efforts in establishing the necessary infrastructure to support sales forces in both the Calgary and European offices, engaging the necessary agents in key strategic global markets and developing the key distribution channels to penetrate new and existing markets.



## Depreciation

(thousands of Canadian dollars)

	2003	2002
Depreciation expense	1,358	802

**Depreciation expense** was \$1.4 million in 2003 compared to \$0.8 million in 2002. This increase is due to the addition of capital assets employed by Dynetek, related to the production of the DyneCell fuel storage systems. The majority of the capital expenditures took place in 2001 with these assets being deployed into the commercial production process during 2002. Until assets are available for use in the production process they are considered assets under construction and are not depreciated.

Depreciation will continue to increase as our production volumes increase and the assets currently not being depreciated are introduced in the production line and are depreciated.

## Amortization

(thousands of Canadian dollars)

	2003	2002
Amortization	387	410

**Amortization** was \$0.4 million in 2003 and \$0.4 million in 2002. Items included in amortization relate to development costs, patents and deferred start-up costs.

Amortization expense is expected to remain the same in future periods as the costs are being amortized on a straight line basis.

## Foreign Exchange

(thousands of Canadian dollars)

	2003	2002
Foreign exchange loss (gain)	1,247	(185)

**Foreign exchange** for the year ended December 31, 2003 was a loss of \$(1.2) million compared to a gain of \$0.2 million in 2002. The Canadian operations invoice revenue in US dollars and the German operations invoice in Euros. The foreign exchange loss in 2003 results from a weakening of the United States dollar against the Canadian dollar throughout the year. The Company is minimizing this risk of foreign exchange fluctuations by converting all US dollar amounts in excess of required US dollar payables into Canadian dollars upon receipt.

At December 31, 2003 the Company had \$1.1 million in US dollars.

The Company plans to continue to mitigate its risk of foreign exchange fluctuations by converting all US dollar amounts in excess of US



dollar payables into Canadian dollars when received. Dynetek has no plans to enter into any foreign exchange forward contracts on its US dollar amounts as the timing of collections of accounts receivable may vary.

### Income Taxes

(thousands of Canadian dollars)

	2003	2002
Future income taxes (benefit)	—	—
Large corporations tax	59	75
	<u>59</u>	<u>75</u>

**Income taxes** were \$0.1 million in 2003 compared to \$0.1 million in 2002. The expense associated with 2003 is attributable to federal large corporations tax, which is based on the taxable capital of the Company. The Company was not cash taxable for the years ended December 31, 2003 and 2002. Due to historical losses the Company has provided a valuation allowance in 2003 against non-capital loss carry-forwards of \$3.4 million.

### NET LOSS

(thousands of Canadian dollars)

	2003	2002
Net loss	(4,888)	(4,933)

**Net loss** for the year ended December 31, 2003 was \$(4.9) million or \$(0.24) per common share which is comparable to 2002. Even though the Company increased revenue in 2003 by 55%, the net loss for 2003 was still comparable to 2002. During 2003 the US dollar weakened considerably throughout the year resulting in a foreign exchange loss of \$(1.2) million compared to a gain of \$0.2 million in 2002. In addition, the costs associated with the initial penetration of the California market reduced the margin for complete system sales to 21% in 2003 compared to 24% in 2002. This had the effect of increasing the loss by approximately \$0.5 million. The Company anticipates the gross margin to improve beyond the 21% levels in 2004.

### VALVE DIVISION

The Valve division is focused entirely on research and development activities. As this Division is currently in its startup phase of operations and focused entirely on research and development activities, these expenditures are included in the research and development expense. The Division experienced a net loss of \$(0.3) million in 2003 which is comparable to 2002. Feedback on these products to date has been positive, and the Division is on schedule to begin selling product in 2004.



## **GERMAN OPERATIONS**

Dynetek Europe GmbH ('Dynetek Germany') has progressed considerably since its inception in 2001 by obtaining cylinder and production certification, developing infrastructure, and marketing the DyneCell throughout Europe, Australia and the Middle East. During 2003 the subsidiary incurred a loss of \$(1.4) million which is comparable to 2002.

Dynetek Germany's cylinder sales increased to \$4.2 million in 2003 from \$0.7 million in 2002. Research and development revenue increased to \$0.6 million from nil in 2002. The majority of Dynetek Germany's sales took place in the last half of the year. The year to date loss is a result of incurring infrastructure costs in the first six months of 2003 with no associated revenue.

In 2004 Dynetek Germany is expected to increase revenues by continuing to penetrate the CNG markets in Europe, Australia and the Middle East. Through increased revenues and the management of expenses the loss should be reduced.



## SUMMARY OF QUARTERLY RESULTS

The following tables show selected unaudited financial information for the past eight quarters ending December 31, 2003. The information has been obtained from our quarterly unaudited financial statements which have been prepared in accordance with Canadian GAAP and, in the opinion of management, have been prepared using accounting policies consistent with the audited financial statements and include all adjustments necessary for the fair presentation of the results of the interim periods. We expect our operating results to vary significantly from quarter to quarter and they should not be relied upon to predict future information.

### 2003 Quarter Ended

(Unaudited)

(thousands of Canadian dollars – except per share amounts)

	THREE MONTHS ENDED				Year to date
	March 31	June 30	September 30	December 31	
<b>Revenues</b>					
Cylinder and system sales	3,278	3,056	4,739	5,275	16,348
Research and development income	1,531	829	1,003	681	4,044
Investment and other income	117	139	75	110	441
	<u>4,926</u>	<u>4,024</u>	<u>5,817</u>	<u>6,066</u>	<u>20,833</u>
<b>Operating expenses</b>					
Cost of goods sold	2,622	2,496	3,612	4,203	12,933
Marketing and G&A	1,152	1,278	1,147	1,385	4,962
Research and product development	1,269	1,749	962	795	4,775
	<u>5,043</u>	<u>5,523</u>	<u>5,721</u>	<u>6,383</u>	<u>22,670</u>
<b>Earnings before interest, taxes, depreciation and amortization*</b>	<u>(117)</u>	<u>(1,499)</u>	<u>96</u>	<u>(317)</u>	<u>(1,837)</u>
Foreign exchange (gain) loss	535	773	(195)	134	1,247
Depreciation and amortization	420	413	475	437	1,745
Income taxes	20	19	20	–	59
	<u>975</u>	<u>1,205</u>	<u>300</u>	<u>571</u>	<u>3,051</u>
<b>Net loss</b>	<u>(1,092)</u>	<u>(2,704)</u>	<u>(204)</u>	<u>(888)</u>	<u>(4,888)</u>
<b>Earnings (loss) per share</b>					
Basic and fully diluted	(0.05)	(0.13)	(0.01)	(0.05)	(0.24)

\* Earnings before interest, taxes, depreciation and amortization (EBITDA) is a non-GAAP measure and may not be comparable to similar measures used by other companies. Management believes EBITDA is a useful measure to assist in the assessment of Dynetek's ability to generate cash flows from its operations.



**2002 Quarter Ended***(Unaudited)**(thousands of Canadian dollars – except per share amounts)*

	THREE MONTHS ENDED				
	March 31	June 30	September 30	December 31	Year to date
<b>Revenues</b>					
Cylinder and system sales	2,458	2,056	2,617	3,740	10,871
Research and development income	621	362	453	529	1,965
Investment and other income	130	172	152	130	584
	<u>3,209</u>	<u>2,590</u>	<u>3,222</u>	<u>4,399</u>	<u>13,420</u>
<b>Operating expenses</b>					
Cost of goods sold	1,833	1,687	2,062	2,656	8,238
Marketing and G&A	848	1,026	1,117	1,820	4,811
Research and product development	659	888	883	1,772	4,202
	<u>3,340</u>	<u>3,601</u>	<u>4,062</u>	<u>6,248</u>	<u>17,251</u>
<b>Earnings before interest, income, depreciation and amortization*</b>	<u>(131)</u>	<u>(1,011)</u>	<u>(840)</u>	<u>(1,849)</u>	<u>(3,831)</u>
Foreign exchange (gain) loss	(85)	128	(3)	(225)	(185)
Depreciation and amortization	347	178	354	333	1,212
Income taxes	22	18	15	20	75
	<u>284</u>	<u>324</u>	<u>366</u>	<u>128</u>	<u>1,102</u>
<b>Net loss</b>	<u>(415)</u>	<u>(1,335)</u>	<u>(1,206)</u>	<u>(1,977)</u>	<u>(4,933)</u>
<b>Earnings (loss) per share</b>					
Basic and fully diluted	(0.02)	(0.06)	(0.06)	(0.10)	(0.24)

\* Earnings before interest, taxes, depreciation and amortization (EBITDA) is a non-GAAP measure and may not be comparable to similar measures used by other companies. Management believes EBITDA is a useful measure to assist in the assessment of Dynetek's ability to generate cash flows from its operations.

**Intangible Assets and Deferred Costs***(thousands of Canadian dollars)*

	2003	2002
Patents	64	1,931
Deferred Costs	44	655
	<u>108</u>	<u>2,586</u>

Intangible asset expenditures for the year ended 2003 were \$0.1 million compared to \$2.6 million in 2002. In 2003, Dynetek spent funds on registering new patents and maintaining existing patents. In the third quarter of 2002 Dynetek announced the acquisition of patents (intellectual property) to enable production of high-pressure solutions for additional components including valves and regulators. The Company will invest in patents in future years to ensure protection of our developed products and production processes. Deferred costs in 2002 and 2003 substantially relate to capitalized start-up costs for the European operations. These amounts will be amortized over a five-year period.

### Capital Expenditures

*(thousands of Canadian dollars)*

	2003	2002
Building and leaseholds	249	40
Manufacturing equipment	1,116	4,227
Office furniture and other equipment	65	7
Computer hardware and software	51	212
Manufacturing equipment under construction	1,895	(2,086)
	<b>3,376</b>	<b>2,400</b>

Capital expenditures for the year ended 2003 were \$3.4 million compared to \$2.4 million for 2002. During 2003 the Company invested \$1.9 million in manufacturing equipment under construction and \$1.1 million on manufacturing equipment used in the commercial production process. The efficiencies and high production capabilities of the new manufacturing process will contribute directly to cost reductions and higher production output. With the additional infrastructure necessary to manage the Company, additions were made to the building, office furniture and computer hardware and software.

The Company's capital resource requirements consist of capital expenditures to maintain and improve the existing production line. In the future the Company's capital requirements are to complete the assets under construction with no other material additions.

### Off Balance Sheet Financing

The Company does not have any Off Balance Sheet Financing arrangements.

### Financial Resources and Liquidity

The Company's principal liquidity requirements relate to the increase in working capital required to maintain our increase in sales.

As at December 31, 2003 Dynetek had cash and cash equivalents of \$9.8 million compared to \$20.5 million at December 31, 2002. This decrease in cash and cash equivalents is attributable to financing working capital levels, purchasing manufacturing equipment, and funding research and development activities. The Company's actual funding requirements will vary depending on a number of factors, including the increase of the CNG system sales on a global basis, the progress of research and development projects and the development of additional relationships with strategic partners. Dynetek remains committed to enhancing our technological leadership and remaining a market leader in the industrial gas fuel storage industry, including CNG and hydrogen.



The Company's accounts receivable position at December 31, 2003 was \$6.0 million compared to \$3.8 million at December 31, 2002. This difference relates to the increase in sales orders from 2002 to 2003. The Company's inventory position at December 31, 2003 was \$6.6 million compared to \$4.4 million at December 31, 2002. This difference relates to the increase in customer demand from 2002 to 2003 requiring higher levels of raw material inventory. Accounts payable at December 31, 2003 was \$3.4 million compared to \$2.8 million as at December 31, 2002. This difference is due to the increase in raw material inventory levels.

The long-term debt relates to research and development funding supplied by NRCan. These agreements allow Dynetek to retain the intellectual property and to receive long-term funding. The debt is repayable in the form of royalties based on specific related commercial product sales. The Company obtained \$0.3 million in funding in 2003 and has \$0.1 million to be repaid in 2004.

Dynetek continues to build on the strong strategic alliances with several major OEMs whereby confidential joint funding has been obtained to develop complete hydrogen fuel storage systems. Other research programs with strategic partners, such as government bodies, who provide financial and technical support, are also in place to explore other storage applications in the energy marketplace.

At December 31, 2003, the Company had an unused \$1.0 million line of credit facility with a major chartered bank.

#### **Transactions with Related Parties**

For the year ended December 31, 2003, the Company purchased under normal terms and conditions \$2.8 million (2002 - \$1.1 million) of material used in the production of lightweight fuel storage systems from Mitsubishi Rayon Corporation, a shareholder of the Company.

#### **Fourth Quarter**

The financial results of the fourth quarter are presented in the section of the MD&A titled "Summary of Quarterly Results".

#### **Critical Accounting Estimates**

The preparation of the Company's financial statements requires management to make estimates and judgments that affect the reported amounts. On an ongoing basis, the Company evaluates its estimates, including those related to bad debts, inventories, fixed asset useful lives, and income taxes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Accounts receivable are recorded as bad debts when they are deemed to be uncollectible. Management reviews specific information on each customer to determine whether collection is an issue. "Other assets" as presented on the balance sheet represent amounts receivable from a customer for which the Company has agreed to revise the terms of repayment. The revised terms of repayment provide for the receivable to be repaid in full on or before June 30, 2006, with interest accruing at a rate of 3% per annum. These revised terms of repayment have been granted based on financial information provided by the customer which supports their ability to repay the amount within the time period noted above.

The Company will review, on a quarterly basis, the ability of the customer to repay this amount in full and consequently the valuation of the amount.

The Company reviews its inventory for obsolescence and to ensure that the cost of inventory is not in excess of the estimated market value. Inventory reserves or write-down are recorded if required.

## **CHANGES IN ACCOUNTING POLICIES**

Effective January 1, 2004, the Company will adopt, CICA Handbook Section 3870 – Stock Based Compensation and Other Stock-Based Payments, which require the fair value method of accounting for stock options. Under this method, Dynetek is required to recognize a charge to the income statement based on an option-pricing model for all stock options that were granted and vested in the financial year, with a corresponding credit to Additional Paid in Capital under the Shareholders' Equity section of the Balance sheet. As the Company has been using the settlement based method of accounting for stock-based compensation, the pro forma cost has not been recorded as an expense for the year ended December 31, 2003. As disclosed in Note 1(n) to the consolidated financial statements, the pro forma cost for the year ended December 31, 2003 of the fair value of stock options granted subsequent to January 1, 2002 was \$1.1 million. Under the revised recommendations, this amount would have been recorded as an expense of the year ended December 31, 2003.

### **Financial Instruments**

#### **a) Fair values**

The carrying amounts reported in the balance sheets for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, approximates their fair values, due to the short terms to maturity of these instruments.

#### **(b) Long-term debt**

The fair value of long-term debt is undeterminable as it has no set terms of repayment and does not bear interest. Accordingly, it is not practical to estimate the fair value of these instruments.

#### **(c) Concentration of credit risk**

The Company is exposed to credit risk only with respect to uncertainty as to timing and amount of collectability of accounts receivable. All customers are subject to credit approval prior to acceptance of purchase order.

#### **(d) Foreign currency risk**

Foreign currency risk is the risk to the Company's results from operations that arises from fluctuations in foreign currency exchange rates. The Company conducts transactions in Canadian dollars, US dollars and the Euro. In 2003 approximately 75% of sales revenue was generated in US dollars, 23% in the Euro and the remaining 2% in Canadian dollars. The Company has not entered into foreign exchange contracts to hedge against gains and losses from foreign currency fluctuations.



## PRINCIPAL RISKS AND UNCERTAINTIES

**Development of the Alternate Fuel Industry and Infrastructure:** Our future performance depends upon the development of the alternate fuel industry and the establishment of the necessary infrastructure. While we believe that the alternate fuel industry will continue to develop and that the necessary infrastructure will be established, we cannot control if, when and how quickly this will happen. The failure or delay in the development of the alternate fuel industry and the establishment of the necessary infrastructure would have a material adverse effect on our operations and financial position.

**Competition in the Fuel Storage Industry:** The gaseous fuel storage industry is highly competitive. We depend upon our ability to develop, manufacture and sell our products in competition against our competitors. We endeavour to offer products that are more advanced and that are cost competitive with our competitors. We also market our products globally and we endeavour to establish strategic relationships with our principal customers. However, we are in competition with competitors who have greater resources and who may develop and introduce competing products that are more advanced and less expensive than our products.

**Dependence upon Transportation OEMs:** Our principal markets are currently automotive OEMs, heavy truck manufacturers and bus manufacturers. We depend upon their continuing development of alternate fuel vehicles and their continuing purchase of our products. We establish strategic relationships with our principal customers and we endeavour to identify new global markets for our products other than transportation OEMs. However, the failure or delay by the transportation OEMs to develop and produce alternate fuel vehicles, or their decision to purchase products from our competitors, would have a material adverse effect on our operations and financial position.

**Technological Changes:** There is significant and rapid technological change in the alternate fuel industry and in the gaseous fuel storage industry. We depend upon our ability to develop, manufacture and sell new products which meet such changes.

**Government and Regulatory Changes:** The development of the alternate fuel industry is driven in part by government laws and regulations concerning the environment, government initiatives concerning greenhouse gases and climate change, and government funding for the alternate fuel industry. Changes in such laws and regulations, initiatives and funding would have a material adverse effect on the alternate fuel industry, which in turn would have a material adverse effect on our operations and financial position.

**Certification:** Our products must be certified in the countries in which they are sold. Certification requirements are evolving and in some cases have not yet been established. While we believe that our products will meet these certification requirements, we cannot control if, when and how quickly this happens. The delay or failure to obtain certifications could have a material adverse effect on our operations and financial position.

**Protection of Intellectual Property Rights:** We depend upon the ownership and protection of our proprietary technology. We endeavour to protect our intellectual property rights through the registration of patents and the protection of trade secrets. However, the loss or unenforceability of any intellectual property rights could have a material adverse effect on our competitive position.

**Dependence upon Suppliers:** We depend upon certain key suppliers for the supply of key materials, components and services at competitive prices. We choose our key suppliers carefully and endeavour to enter into strategic alliances with them. However, the loss of any key supplier or pricing structure could have a material adverse effect on our costs, operations and financial position.

**Dependence upon Key Personnel:** We depend upon certain key management, operations and research and development personnel. We endeavour to obtain written employment agreements with such personnel containing confidentiality and non-competition provisions. However, the loss of any such personnel or the unenforceability of such confidentiality and non-competition provisions could have a material adverse effect on our operations, competitive position and financial position.

**Credit Risks:** We are exposed to credit risk for payments by customers for our products. We manage this risk by primarily dealing with large, credit worthy customers and governments. However, a failure to pay by any significant customer could have a material adverse effect on our financial position.

**Foreign Exchange:** We are exposed to foreign currency fluctuations, since a majority of our accounts receivable are in US dollars. We endeavour to manage this risk by matching our US dollar balances to planned purchases in US dollars, and by keeping a minimum of the balance of our cash in US dollars. However, significant fluctuations in foreign exchange could have a material adverse effect on our financial position.

**Product Liability and Insurance:** We carry insurance that we consider appropriate, considering the nature of risks and the costs of insurance. However, all such insurance is subject to deductibles and exclusions and is not always available for all risks or at affordable prices. An uninsured or excluded loss could have a material adverse effect on our financial position.

## CORPORATE GOVERNANCE

Details of Dynetek's corporate governance are contained in the Company's Information Circular prepared for the Annual Meeting of the Shareholders to be held on May 11, 2004. Copies of the Information Circular are available from the Company on request and are mailed to shareholders of record along with the Annual Report.

## SAFETY AND ENVIRONMENT

Dynetek employees' safety is of paramount concern in all facets of our operations and in all regions where we operate. The Company has developed and rigidly enforces formal safety policies and procedures. The Company's policy is to operate its business in a manner which maintains compliance with the relevant safety legislation, and preventive action is taken to ensure that safety hazards do not exist. Dynetek uses environmentally friendly products that pose less of a safety risk or risk of pollution wherever possible.



## MISSION AND STRATEGY

Our business strategy is to continue to take advantage of current opportunities in the rapidly expanding international market for compressed natural gas and other compressed gases, such as oxygen and helium, while also advancing our compressed hydrogen enabling technologies for the coming hydrogen economy.

The Company focuses on near term revenue investment opportunities that are generated on a global basis related to the CNG market. We will target geographic market opportunities that are environmentally and economically driven. Although we will enter markets which offer government incentives to grow the alternative fuel market, we are careful to ensure the government commitments have long term capital resources and political support. We will also ensure our capital exposure is not extended or too reliant on this customer base for future revenues, in the event the incentives for alternative fuel use are terminated or delayed indefinitely for whatever reasons.

The Company will continue to review and evaluate the benefits of Joint Ventures and merger and acquisition opportunities with our customers, strategic partners and other participants in the alternative fuel industry. We will review product offering synergies, market growth opportunities, profitability timelines, company management, strategic partners and will complete internal valuation models. To date no opportunities have successfully met all the criteria.

We continually survey and evaluate the benefits of strategic alliances with others in the industry. We focus these alliances on either our marketing strategy to expand our distribution channels or on our development strategy to advance the state of our technology. To date we have entered into alliances to expand both our marketing and development initiatives.

The Company will continue to develop our hydrogen enabling technologies to assist in expediting the commercialization of the hydrogen economy. We will continue to apply our system integration and complete solution expertise in the OEM vehicle applications and with energy and petroleum companies in providing the initial refueling products such as our mobile refueling units, storage for stationary refueling units and hydrogen storage for bulk hauling trailers.

The Company intends to continue to focus on research and development efforts on advancing our enabling technologies to further improve performance and reduce cost. The Company will review and evaluate all research and development projects to ensure they are commercially viable for generating revenues in the 2-3 year range.

## OPERATIONS

Revenues from cylinder and system sales related to compressed natural gas for 2004 are expected to increase over 2003. Increased system sales are expected from the European operations, Japanese markets and CNG opportunities in California.

Revenue from hydrogen cylinder and system sales will vary on a quarter-to-quarter basis. This revenue is dependent on the strategic plans of OEMs and other customer requirements for hydrogen storage solutions, which the Company has no ability to predict or control.

Dynetek believes that its cash will provide sufficient capital to fund current operations over the foreseeable future. Cash usage is dependent on positive cash flow from operations, the amount of capital additions to be incurred and working capital requirements for revenue growth. The Company monitors very closely the working capital requirements as a result of the revenue growth.

## MANAGEMENT'S REPORT

The management of Dynetek Industries Ltd. is responsible for the integrity of its reported financial data. In the opinion of management, the consolidated financial statements have been prepared within acceptable limits of materiality, and are in accordance with Canadian generally accepted accounting principles appropriate in the circumstances. Management maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded and that the relevant and reliable financial information is provided in a timely manner. Management is responsible for all information contained in the annual report and for ensuring that this information is consistent, where appropriate, with the information and data contained in the financial statements.

External auditors, appointed by the shareholders, have examined the consolidated financial statements in accordance with generally accepted auditing standards in Canada and have provided an independent professional opinion.

The Board of Directors carries out its responsibility for the financial reporting and internal controls principally through its Audit Committee. The Audit Committee consists of three directors, two of which are not involved in the daily operations of the Company. This committee has met with the external auditors and management in order to determine if management has fulfilled its responsibilities in the preparation of the financial statements. The Board of Directors has approved the consolidated financial statements on the recommendation of the Audit Committee.



Heinz O. Portman  
Chairman of the Board



Robb D. Thompson  
President and CEO

## AUDITORS' REPORT

To the Shareholders of Dynetek Industries Ltd.:

We have audited the consolidated balance sheet of Dynetek Industries Ltd. as at December 31, 2003 and the consolidated statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at December 31, 2002 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those financial statements in their report dated March 14, 2003.



Chartered Accountants  
Calgary, Canada


March 10, 2004

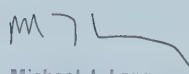


**Dynetek Industries Ltd.**  
**Consolidated Balance Sheets**  
**December 31**  
*(thousands of Canadian dollars)*

	2003	2002
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	9,831	20,453
Accounts receivable	5,975	3,843
Inventory (note 2)	6,576	4,381
Prepaid expenses	686	691
	<b>23,068</b>	<b>29,368</b>
<b>Other asset (note 3)</b>	<b>597</b>	<b>—</b>
<b>Intangible assets and deferred costs (note 4)</b>	<b>3,802</b>	<b>4,081</b>
<b>Capital assets (note 5)</b>	<b>15,435</b>	<b>13,417</b>
<b>Future income tax asset (note 7)</b>	<b>2,505</b>	<b>2,505</b>
	<b>45,407</b>	<b>49,371</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	3,408	2,833
Current portion of long-term debt (note 6)	108	55
	<b>3,516</b>	<b>2,888</b>
<b>Long-term debt (note 6)</b>	<b>1,753</b>	<b>1,457</b>
<b>Shareholders' Equity</b>		
Share capital (note 8)	52,249	52,249
Deficit	(12,111)	(7,223)
	<b>40,138</b>	<b>45,026</b>
	<b>45,407</b>	<b>49,371</b>

See accompanying notes to the consolidated financial statements  
Approved by the Board of Directors

  
Peter A. Leus  
Director

  
Michael J. Lang  
Director

**Dynetek Industries Ltd.**  
**Consolidated Statements of Operations and Deficit**  
**Years Ended December 31**  
*(thousands of Canadian dollars except per share capital and per share amounts)*

	2003	2002
<b>Revenue</b>		
Sales	16,348	10,871
Research and development	4,044	1,965
Investment and other	441	584
	<b>20,833</b>	<b>13,420</b>
<b>Expenses</b>		
Cost of goods sold	12,933	8,238
General and administrative	3,458	3,232
Research and product development	4,775	4,202
Marketing	1,504	1,579
Depreciation	1,358	802
Amortization	387	410
Foreign exchange loss (gain)	1,247	(185)
	<b>25,662</b>	<b>18,278</b>
<b>Loss before taxes</b>	<b>(4,829)</b>	<b>(4,858)</b>
<b>Provision for taxes</b> (note 7)		
Future income taxes (benefit)	—	—
Large corporations tax	59	75
	<b>59</b>	<b>75</b>
<b>Net loss</b>	<b>(4,888)</b>	<b>(4,933)</b>
Deficit, beginning of year	(7,223)	(2,290)
<b>Deficit, end of year</b>	<b>(12,111)</b>	<b>(7,223)</b>
<b>Per Share Information</b>		
Loss per share (basic and diluted)	(0.24)	(0.24)
Weighted average number of common shares outstanding	20,120,395	20,120,395

See accompanying notes to the consolidated financial statements



**Dynetek Industries Ltd.**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31**  
*(thousands of Canadian dollars)*

	2003	2002
<b>Cash flows provided for by (used for) operating activities</b>		
<b>Net loss</b>	<b>(4,888)</b>	<b>(4,933)</b>
Items not involving cash:		
Depreciation	1,358	802
Amortization	387	410
Unrealized foreign exchange loss (gain)	2,471	(748)
	<b>(672)</b>	<b>(4,469)</b>
<b>Changes in non-cash working capital</b>		
Accounts receivable	(2,132)	(511)
Inventory	(2,195)	(2,704)
Prepaid expense	5	(478)
Accounts payable	575	365
Unrealized foreign exchange loss (gain) relating to non-cash working capital	(1,255)	(218)
	<b>(5,674)</b>	<b>(8,015)</b>
<b>Investing Activities</b>		
Additions to other asset	(597)	—
Additions to intangible assets and deferred costs	(108)	(2,586)
Additions to capital assets	(3,376)	(2,400)
	<b>(4,081)</b>	<b>(4,986)</b>
<b>Financing Activities</b>		
Advances, long-term debt	349	504
Repayment, long-term debt	—	(88)
	<b>349</b>	<b>416</b>
Foreign exchange (loss) gain on cash held in foreign currency	(1,216)	966
<b>Decrease in cash and cash equivalents</b>	<b>(10,622)</b>	<b>(11,619)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>20,453</b>	<b>32,072</b>
<b>Cash and cash equivalents, end of year</b>	<b>9,831</b>	<b>20,453</b>

Cash and cash equivalents includes a reduction for outstanding cheques. Interest income received during the year was \$0.3 million (2002 - \$0.6 million) and interest paid during the year was \$ nil (2002 - \$ nil). Income taxes paid during the year was \$59,000 (2002 - \$75,000).

See accompanying notes to the consolidated financial statements

**Dynetek Industries Ltd.**  
**Notes to Consolidated Financial Statements**  
**For the years ended December 31, 2003 and 2002**  
*(Tabular amounts in thousands of Canadian dollars, except where noted)*

**1. Significant accounting policies**

**(a) Description of business**

Dynetek Industries Ltd. ('the Company' or 'Dynetek') designs, manufactures and markets complete lightweight compressed gas fuel storage systems for alternative fuel technologies and industrial gas suppliers. The Company's principal customers are major creditworthy industrial companies and government agencies.

**(b) Consolidation**

The consolidated financial statements include the accounts of Dynetek and its wholly owned subsidiary Dynetek Europe GmbH.

**(c) Use of Estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires the Company's management to make estimates and assumptions that affect the amounts reported in these financial statements and notes thereto. Actual results could differ from those estimates.

**(d) Cash and cash equivalents**

Cash and cash equivalents consist of cash on deposit and highly liquid short-term interest bearing securities with maturities at the date of purchase of three months or less.

**(e) Inventory**

Inventories, which include materials, labour, and overhead, are valued at the lower of cost and net realizable value, with cost being determined on a weighted average basis.

**(f) Intangible assets and deferred costs**

Intangible assets are initially recorded at cost and are amortized on a straight-line basis over period of 17 years from the date of acquisition. Deferred costs represent capitalized start-up costs and are amortized on a straight-line basis over five years, beginning in the first year of commercial operations.

**(g) Capital assets**

Capital assets are initially recorded at cost and are depreciated from the date of acquisition or, in respect of manufacturing equipment under construction, from the time an asset is completed and ready for commercial production. Depreciation is provided over the useful lives of the asset as follows:



**Dynetek Industries Ltd.****Notes to Consolidated Financial Statements (con't)****For the years ended December 31, 2003 and 2002***(Tabular amounts in thousands of Canadian dollars, except where noted)*

Building	declining balance	4%
Manufacturing equipment	declining balance	20%
Office furniture and other equipment	declining balance	4 to 30%
Computer hardware	declining balance	30%
Computer software	declining balance	25%
Leaseholds	straight line	5 years

**(h) Research and development costs**

Research and development costs are expensed as incurred.

**(i) Future income taxes**

The Company uses the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on "temporary differences" (differences between the accounting basis and the tax basis of the assets and liabilities) and are measured using enacted or substantially enacted tax rates and laws expected to apply when these differences reverse. Income tax expense is the sum of the Company's provision for current income taxes and the differences between opening and ending balances of the future income tax assets and liabilities.

**(j) Government assistance**

Government assistance is received from Natural Resources Canada and is recorded as non-interest bearing long-term debt, as described in note 6.

**(k) Revenue recognition**

Cylinder and system revenue is recognized when finished goods are shipped and invoiced to the customer. Research and development revenue is generated by projects co-funded with the original equipment manufacturers (OEMs). This revenue is recognized when invoiced. Invoicing occurs when contractual deliverables are met. Timing differences can occur between when costs are incurred and when revenue is invoiced and earned.

**(l) Foreign currency**

Monetary items denominated in currencies other than Canadian dollars are translated to Canadian dollars at exchange rates in effect at the balance sheet date. Non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligation incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in results from operations.

The Company's foreign operation is integrated and is translated into Canadian dollars using the temporal method. Translation adjustments are reflected in the Statement of Operations and Deficit.

**Dynetek Industries Ltd.****Notes to Consolidated Financial Statements (con't)****For the years ended December 31, 2003 and 2002**

*(Tabular amounts in thousands of Canadian dollars, except where noted)*

**(m) Per common share amounts**

Amounts per common share are based on the weighted average number of common shares outstanding during the year. Diluted per share amounts are calculated using the treasury stock method, which assumes that any proceeds obtained on exercise of options would then be used to purchase common shares at the weighted average market price during the year. The weighted average number of common shares outstanding is then adjusted by the net change. Diluted net loss per common share, is not presented, as the effects of the outstanding items are not dilutive. The weighted average number of common shares outstanding at December 31, 2003 was 20,120,395 (2002 – 20,120,395). The number of common shares used in the dilution calculation in 2003 was 20,120,395 (2002 – 20,233,877).

**(n) Stock option plan**

Effective January 1, 2002, the Company adopted, on a prospective basis, the Canadian Institute of Chartered Accountants ("CICA") recommendations for accounting for stock-based compensation. The standard requires the Company to account for direct share awards and grants of options to non-employees using the fair value method of accounting for stock-based compensation. Options granted to employees and directors are accounted for using the settlement date method of accounting for stock-based compensation. Accordingly, no compensation cost has been recognized for such grants as the exercise price is equal to or greater than the market price of the stock on the date of grant.

If the compensation cost for the employees stock option plan had been determined using the fair value method of accounting for stock-based compensation, the Company would have increased the 2003 loss by \$(0.6) million or \$(0.03) per share (2002 – \$(0.5) million or \$(0.02) per share).

The value was determined using the Black-Scholes valuation model assuming an average option life of five years, no dividends, expected volatility ranging from 85% to 132% and a risk-free rate ranging from 2.3% to 3.18%. In 2003, the estimated weighted average fair value per option was \$1.22 (2002 - \$1.43).

Commencing January 1, 2004, the Company will adopt the new CICA requirements to expense stock options in the financial statements, retroactively without prior period restatement. This will result in a charge to opening retained earnings of \$(1.1) million on January 1, 2004.

**(o) Comparative figures**

Certain comparative figures have been reclassified to conform with the basis of presentation in the current year.

<b>2. Inventory</b>	<b>2003</b>	<b>2002</b>
Raw materials	<b>1,869</b>	951
Work-in-progress	<b>1,334</b>	1,120
Finished goods	<b>3,373</b>	2,310
	<b>6,576</b>	4,381



**Dynetek Industries Ltd.****Notes to Consolidated Financial Statements (con't)****For the years ended December 31, 2003 and 2002***(Tabular amounts in thousands of Canadian dollars, except where noted)***3. Other Assets**

Other assets represents amounts receivable from a customer for which the Company has agreed to revise the terms of repayment. The revised terms of repayment provide for the receivable to be repaid in full on or before June 30, 2006, with interest accruing at a rate of 3% per annum. These revised terms of repayment have been granted based on financial information provided by the customer which supports their ability to repay the amount within the time period noted above. The Company will review, on a quarterly basis, the ability of the customer to repay this amount in full and consequently the valuation of the amount.

**4. Intangible Assets and Deferred Costs**

	<b>Cost</b>	<b>Accumulated depreciation</b>	<b>2003 Net book value</b>	<b>Cost</b>	<b>Accumulated depreciation</b>	<b>2002 Net book value</b>
Patents	2,776	211	2,565	2,712	51	2,661
Deferred costs	1,464	227	1,237	1,420	—	1,420
	<b>4,240</b>	<b>438</b>	<b>3,802</b>	<b>4,132</b>	<b>51</b>	<b>4,081</b>

**5. Capital Assets**

	<b>Cost</b>	<b>Accumulated depreciation</b>	<b>2003 Net book value</b>	<b>Cost</b>	<b>Accumulated depreciation</b>	<b>2002 Net book value</b>
Land	514	—	514	514	—	514
Building and leaseholds	3,379	590	2,789	3,130	422	2,708
Manufacturing equipment	7,715	2,949	4,766	6,599	1,876	4,723
Office furniture and other equipment	618	284	334	553	209	344
Computer hardware and software	616	279	337	565	237	328
Manufacturing equipment under construction	6,695	—	6,695	4,800	—	4,800
	<b>19,537</b>	<b>4,102</b>	<b>15,435</b>	<b>16,161</b>	<b>2,744</b>	<b>13,417</b>

Manufacturing equipment under construction represents costs associated with asset construction prior to commercial production at which time depreciation will commence.

**Dynetek Industries Ltd.****Notes to Consolidated Financial Statements (con't)****For the years ended December 31, 2003 and 2002***(Tabular amounts in thousands of Canadian dollars, except where noted)***6. Long-term debt**

	2003	2002
Loan, unsecured, non-interest bearing, repayment based on 3 to 5% of product related sales, payable in the following fiscal period	1,861	1,512
Less: current portion of long-term debt	(108)	(55)
	1,753	1,457

The repayment of unsecured long-term debt beyond the current year is indeterminable, as amounts owing are based on future sales.

The Company has a \$1.0 million line of credit with a major Canadian Chartered Bank, which is payable on demand and bears interest at the bank prime rate plus 1.25% per annum. The bank line is secured by an assignment of book debts and inventory. No amounts were outstanding at December 31, 2003 and 2002.

**7. Provision for income taxes**

The provision for income taxes differs from the amount, which would be obtained by applying the expected Canadian Income Tax rate as follows:

	2003	2002
Loss before income taxes	(4,888)	(4,858)
Statutory income tax rate	34.7%	39.2%
Expected income tax reduction	(1,696)	(1,904)
Add (deduct):		
Substantively enacted tax rate reduction	6	35
Valuation adjustment	2,740	1,747
Other	(1,050)	122
Future income tax (benefit)	—	—
Large corporations tax	59	75
	59	75



**Dynetek Industries Ltd.****Notes to Consolidated Financial Statements (con't)****For the years ended December 31, 2003 and 2002***(Tabular amounts in thousands of Canadian dollars, except where noted)*

The components of the net future income tax asset at December 31 are as follows:

	2003	2002
Research and development costs	696	1,964
Capital assets	2,170	284
Share issue costs	239	564
Non-capital losses	2,140	1,440
Valuation adjustment	(2,740)	(1,747)
Future Income Tax Asset	2,505	2,505

The Company has Canadian non-capital loss carry-forwards of \$3.4 million expiring over a period from 2007 through 2010.

**8. Share capital**

**(a) Authorized:** Unlimited common shares with no par value.

Unlimited preferred non-voting shares, issuable in series, at no par value.

**(b) Issued and outstanding:**

	Number of shares	Amount
Balance December 31, 2000	19,530,599	50,247
Common shares issued on private placement	586,031	2,154
Warrants exercised	3,765	14
Share issue costs	—	(44)
Future income tax rate change for share issue costs	—	(122)
Balance December 31, 2001, 2002 and 2003	20,120,395	52,249

**Dynetek Industries Ltd.****Notes to Consolidated Financial Statements (con't)****For the years ended December 31, 2003 and 2002***(Tabular amounts in thousands of Canadian dollars, except where noted)***(c) Options:**

At December 31, 2003, 2,200,500 (2002-1,942,000) options to purchase common shares were outstanding. An additional 399,500 options may be granted in future years under this plan. Options vest ranging over three or four years, with no options vesting on date of issue. Options outstanding under the plan are as follows:

	Number of Options	Weighted Average Price Per Share
Balance December 31, 2000	1,717,500	\$6.53
Options granted	107,000	\$4.35
Options cancelled	(26,000)	\$6.06
Balance December 31, 2001	1,798,500	\$6.39
Options granted	759,000	\$2.73
Options cancelled	(615,500)	\$6.49
Balance December 31, 2002	1,942,000	\$4.93
Options granted	323,000	\$1.68
Options cancelled	(64,500)	\$2.55
	2,200,500	\$4.52

The following table summarizes information about the options outstanding.

Date granted	Expiry Dates	Price per share	Number of shares	Available to Exercise
December 23, 1999	December 22, 2004	\$1.13	260,000	260,000
September 21, 2000	September 20, 2010	\$7.50	980,000	980,000
August 8, 2001	August 8, 2011	\$4.35	20,000	13,333
January 10, 2002	January 10, 2012	\$2.95	483,000	133,625
May 15, 2002	May 15, 2012	\$2.95	63,000	17,417
August 12, 2002	August 12, 2012	\$1.50	4,500	1,125
November 6, 2002	November 6, 2012	\$0.95	67,000	23,750
March 14, 2003	March 14, 2013	\$1.41	40,000	—
May 8, 2003	May 8, 2013	\$1.26	14,000	—
November 18, 2003	November 18, 2013	\$1.49	9,000	—
November 25, 2003	November 25, 2013	\$1.75	260,000	—

**(d) Warrants**

On February 3, 2000, the Company issued 1,200,000 share purchase warrants which were to expire on September 21, 2003 and are exercisable into common shares of the Company at U.S. \$1.01 per share. Effective May 23, 2003 the warrants were revised to extend the expiry date to May 19, 2005. None have been exercised to date.

On August 21, 2000, the Company issued warrants to Ford Motor Company to purchase 1,174,294 common shares. The warrants have



## Notes to Consolidated Financial Statements (con't)

### (d) Warrants (con't)

an exercise price of \$3.68 per share and are earned one third immediately and thereafter in accordance with a formula based on revenue received by the Company. No additional warrants have been earned or exercised to date. The warrants expire on the date which is the later of five years from the date of issuance and three years from the date such portion of the warrants become vested and provided that no expiration date shall be later than January 31, 2014.

## 9. Financial instruments

### (a) Fair values

The carrying amounts reported in the balance sheets for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, approximates their fair values, due to the short terms to maturity of these instruments.

### (b) Long-term debt

The fair value of long-term debt is undeterminable as it has no set terms of repayment and does not bear interest. Accordingly, it is not practical to estimate the fair value of these instruments.

### (c) Concentration of credit risk

The Company is exposed to credit risk only with respect to uncertainty as to timing and amount of collectability of accounts receivable. All customers are subject to credit approval prior to acceptance of purchase order.

### (d) Foreign currency risk

Foreign currency risk is the risk to the Company's results from operations that arises from fluctuations in foreign currency exchange rates. A significant portion of the Company's revenues and expenses are denominated in United States dollars. The Company has not entered into foreign exchange contracts to hedge against gains and losses from foreign currency fluctuations.

## 10. Segmented information

The Company currently operates in one operating segment, which involves the manufacture and sale of lightweight fuel storage systems. The majority of the Company's operations and assets relating to commercial production were located in Canada at December 31, 2003. Revenues attributed to foreign countries are based on the location of the customer.

	2003	2002
<b>Revenue</b>		
Canada	3,334	1,090
United States	4,363	5,782
Japan	4,012	1,422
European Union	4,639	2,577
	<b>16,348</b>	<b>10,871</b>

## 11. Related party transaction

For the year ended December 31, 2003, the Company purchased under normal terms and conditions \$2.8 million (2002 - \$1.1 million) of material used in the production of lightweight fuel storage systems from Mitsubishi Rayon Corporation, a shareholder of the Company.



# CORPORATE INFORMATION

Dynetek AGM  
May 11, 2004  
Dynetek Head Office

## BOARD OF DIRECTORS

Heinz O. Portmann\*  
Chairman of the Board  
Dynetek Industries Ltd.  
Calgary, Alberta

Andrew T.B. Stuart √  
President and Chief Executive Officer  
Sustainable Shift Inc.  
Mississauga, Ontario

Peter A. Leus\*†  
Director  
Starlaw Holdings Ltd.  
Montreal, Quebec

Michael J. Lang\*†  
Chairman  
Stonebridge Merchant Capital Corp.  
Calgary, Alberta

Larry A. Wright √  
Executive Vice President  
Multimatic Inc.  
Markham, Ontario

Robb D. Thompson  
President and Chief Executive Officer  
Dynetek Industries Ltd.  
Calgary, Alberta

## OFFICERS AND MANAGEMENT

Heinz O. Portmann  
Chairman of the Board

Robb D. Thompson  
President and Chief Executive Officer

Michael D. Portmann  
Vice President and General Manager

Ulrich Imhof  
Vice President, Engineering

Dr. Christian Rasche  
Managing Director  
Dynetek Europe GmbH

Karen Y. Minton  
Vice President, Finance  
and Administration

Tim A. Richard  
Vice President, Sales and Marketing

Norman E. Hall  
Corporate Secretary

## CORPORATE HEAD OFFICE

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## BANKERS

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Calgary, Alberta

## AUDITORS

Deloitte & Touche LLP  
Calgary, Canada

## LEGAL COUNSEL

Gowling Lafleur Henderson LLP  
Calgary, Alberta

## TRANSFER AGENT AND REGISTRAR

CIBC Mellon Trust Company  
with offices in Toronto, Montreal and  
Calgary

## STOCK LISTING

Toronto Stock Exchange  
Trading Symbol: DNK

## INVESTOR RELATIONS

To obtain additional information  
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## Robb D. Thompson

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† Compensation Committee member  
√ Corporate Governance Committee member



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**Dynetek Industries Ltd.**